



BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission

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IN THE MATTER OF COMPETITION  
IN THE PROVISION OF ELECTRIC  
SERVICES THROUGHOUT THE STATE  
OF ARIZONA

DOCKET NO. U-0000-94-165

COMMENTS OF ARIZONA'S  
ELECTRIC COOPERATIVES  
ON THE DRAFT RULES

On August 28, 1996, the Staff circulated Draft Rules on electric industry restructuring ("Draft Rules") and requested comments by September 12, 1996. These comments are submitted on behalf of the Arizona Electric Power Cooperative, Inc. ("AEPCO"), Duncan Valley Electric Cooperative and Graham County Electric Cooperative. Further, Trico Electric Cooperative, Mohave Electric Cooperative, Sulphur Springs Valley Electric Cooperative and Navopache Electric Cooperative join in these comments as well.

Introduction

The Draft Rules are far-reaching and will have a tremendous impact on the electric industry in Arizona and on the citizens of this state. Although in March and April, 1996, an Attorney Task Force assembled by Staff issued a document identifying some 67 separate legal issues,<sup>1</sup> including

<sup>1</sup> In a letter dated April 18, 1995 AEPCO raised 35 legal issues: 7 of them concerned the Arizona Constitution, 19 of them were specific to rural electric cooperatives, including Federal questions, and 9 of them raised other important considerations. The Cooperatives do not waive those and other issues by not including them here; the brief time allowed for comments simply precludes their full discussion now. The Cooperatives have, however, summarized some of the most compelling of those issues below.

1 constitutional, regulatory, statutory and Federal questions as a  
2 starting point for discussion, none of those concerns have been  
3 addressed by Staff in the Draft Rules. These are critical legal  
4 issues which must be resolved before the Commission acts to adopt  
5 rules. Belief in retail competition does not confer upon the  
6 Commission regulatory authority beyond that granted by law.

7         Some of these issues are unique to AEPCO and Arizona's  
8 distribution rural electric cooperatives: Duncan Valley Electric  
9 Cooperative, Graham County Electric Cooperative, Mohave Electric  
10 Cooperative, Navopache Electric Cooperative, Sulphur Springs  
11 Valley Electric Cooperative, and Trico Electric Cooperative  
12 (collectively, "the Cooperatives"). They are, therefore, raising  
13 again the issues which make them, as rural electric cooperatives,  
14 different from the rest of the industry in the sound belief that  
15 rural electric cooperatives should be "carved-out" of the Rules.

16         The Cooperatives are not opposed to retail competition  
17 and restructuring which benefits their members-owners, the rural  
18 consumers. However, if adopted, the Draft Rules would place at  
19 risk most of the benefits rural consumers have accrued in the  
20 cooperative system. It would be paradoxical if restructuring is  
21 achieved by placing rural consumers at an economic and regulatory  
22 disadvantage. The Cooperatives therefore ask the Commission to  
23 delete them from the definition of "Affected Utilities" in R14-2-  
24 xxx1.

25         In the event the Commission includes the Cooperatives,  
26 we have also proposed specific changes in the rules and/or offered

1 specific comments on them. While adoption of these and other  
2 changes would improve the rules product, they are not a  
3 satisfactory solution to the unique problems faced by the  
4 Cooperatives.

5 **I. THE DRAFT RULES WILL FRUSTRATE FEDERAL LAW, IMPAIR CONTRACTS,**  
6 **CAUSE MORTGAGE DEFAULTS AND ENDANGER THE COOPERATIVES' TAX**  
7 **EXEMPTION.**

8 Rural electric systems are inherently more costly than  
9 urban ones. The areas served are sparsely populated and loads,  
10 like irrigation, while vital to a rural economy, cost more to  
11 serve. Delivering energy costs more in rural areas and the  
12 capital investment on a per customer basis is substantially  
13 higher.

14 In light of this, the United States Congress, both in  
15 the Rural Electrification Act (RE Act) and in the Rural  
16 Electrification Loan Restructuring Act of 1993 determined that the  
17 national interest would be served by loan support of the rural  
18 electric system. Consequently, dependable and affordable rural  
19 electric service has been developed by cooperatives, funded by the  
20 loan programs of the Rural Utilities Service ("RUS"), formerly the  
21 REA, which also regulates the cooperatives' activities. Further,  
22 most cooperatives use a tax exemption, embodied in §501(c)(12) of  
23 the Internal Revenue Code (26 U.S.C. § 501(c)(12)), to reduce  
24 these higher than normal costs.

25 As currently drawn, the Draft Rules imperil this  
26 successful Federal program in several ways. Among other things,  
implementation would endanger the cooperatives' tax exempt status

1 and disrupt the contractual and financing base upon which the  
2 system rests.

3 A. The Draft Rules endanger the Cooperatives' tax exempt  
4 status.

5 The not-for-profit tax-exempt corporate structure of  
6 cooperatives serves rural areas well. The Cooperatives must meet  
7 a number of criteria to keep their § 501(c)(12) status intact each  
8 tax year. Among these is the requirement that no more than 15  
9 percent of the cooperative's annual income (revenues) be derived  
10 from nonmembers. The Draft Rules threaten this exemption.

11 For example, they would require AEPCO to wheel  
12 generation for others to reach and use the distribution lines of  
13 its member cooperatives to serve retail loads. If the revenues  
14 from these required wheeling sales to nonmembers exceed 15 percent  
15 of AEPCO's annual revenues, AEPCO would lose its tax exempt  
16 status. Of potentially far greater impact is the Draft Rules'  
17 requirement that a distribution system provide both wheeling over  
18 its distribution lines and generation supply from an entity other  
19 than its G&T. Billing for both power supply and delivery and  
20 receiving those revenues from nonmembers would cause the  
21 distribution cooperative to lose its tax exempt status.

22 In response to this potential loss of tax exemption,  
23 FERC provided in Order 888, Footnote 499, that "reciprocal service  
24 will not be required if providing such service would jeopardize  
25 the G&T cooperative's tax-exempt status" (61 Fed Register 21614,  
26 FN 499). The FERC further, in Footnote 500, indicated that the  
tariff offered by such a transmission provider could "include a

1 provision permitting the transmission provider to refuse service  
2 if providing such service would jeopardize its tax-exempt  
3 status....."

4 The same result should be accomplished in these Draft  
5 Rules by simply exempting Cooperatives from the definition of  
6 "Affected Utilities."

7 B. The Draft Rules must accommodate the interlocking two-  
8 tiered organizational structure and generation-delivery  
9 system of rural electric cooperatives.

10 The Draft Rules envision a traditional electric industry  
11 of investor-owned vertically integrated utilities. Nonprofit  
12 rural electric cooperatives are significantly different. The  
13 Cooperatives have a two-tiered organizational structure bound  
14 together by contracts to make it function properly.

15 Individual consumers are member-owners of the  
16 distribution cooperative that provides electricity directly to  
17 them through a system built and owned by that cooperative. The  
18 member-owners elect a board of directors to operate their  
19 cooperative. To allow for equitable cost sharing, they are  
20 required by the bylaws to purchase electric power only from their  
21 distribution cooperative and they are bound contractually to that  
22 same promise.

23 Distribution cooperatives, in turn, are member-owners of  
24 generation and transmission cooperatives, like AEPCO, that  
25 generate and otherwise procure electricity and deliver it to the  
26 distribution systems over transmission systems owned by the G&T.  
Like their member-owners, the distribution cooperatives can only

1 purchase electric power from their G&T through an all-requirements  
2 wholesale contract.

3           Although the G&T and its distribution members are  
4 essentially one economic unit, they are separate legal entities  
5 with separate boards of directors with no legal authority to order  
6 each others' members to take any action. They are not investor-  
7 owned vertically integrated utilities which operate on a profit  
8 making basis for the benefit of shareholders. They are  
9 operationally, financially and structurally different. There are  
10 no shareholders to bear risk in hopes of rewards; there are only  
11 member-owners whose rates are dependent upon the financial health  
12 of their cooperative.

13           In many areas, the Draft Rules simply overlook these  
14 strategic and structural differences. Consequently, the Draft  
15 Rules would impair all of these contractual relationships, which  
16 are unique to cooperatives.

17           The Cooperatives don't believe that such a result is  
18 intended by the Draft Rules. One of the Draft Rules' provisions  
19 expressly recognizes the importance of honoring existing  
20 contractual relationships. R14-2-xxx4.F states that consumers  
21 under contract may only participate in the competitive market  
22 prior to contract expiration if both parties agree. As discussed  
23 above, the retail member is the contract consumer of the  
24 distribution cooperative and the distribution cooperative is the  
25 contract consumer of the G&T. Yet, by including cooperatives in  
26 the definition of Affected Utilities, the Draft Rules, at best,

1 set up an ambiguity and, at worst, conflict on this essential  
2 point.

3 The Commission may resolve this conflict in one of two  
4 ways. Either "carve out" the Cooperatives and eliminate the  
5 conflict or recognize that until these contractual relationships  
6 are changed by the parties, the Cooperatives will not be  
7 participants under the Draft Rules.

8 C. The Draft Rules should recognize the law of the  
9 Federally-designed system.

10 As RUS stated in its FERC open-access rulemaking filing,  
11 "The RE Act authorizes RUS to make loans and loan guarantees to  
12 provide and improve electric service only to consumers in rural  
13 areas." This government support is meant to serve RE Act  
14 beneficiaries. RUS makes direct loans to distribution  
15 cooperatives while G&T's generally receive RUS guarantees on loans  
16 from other lenders.

17 Since most G&T revenues come from its distribution  
18 members, RUS requires, as a condition of a loan or loan guarantee,  
19 that the G&T's distribution member-owners enter into a long term  
20 wholesale power contract to purchase all of their requirements  
21 from the G&T.

22 The Commission's Draft Rules would require that these  
23 federally supported facilities be made available to companies that  
24 are not the intended beneficiaries of the RE Act. The  
25 Cooperatives then will face at least two dilemmas. First, future  
26 financing for required facilities may not be available from RUS  
because no assurance can be given that funds will be spent

1 consistent with the purpose of the RE Act. Second, as to  
2 outstanding loans, unless the Cooperatives could show that the  
3 primary purpose of the financed facilities still primarily  
4 supports the RE Act beneficiaries they will be in default on their  
5 loans.

6 While RUS and/or Congressional solutions to these issues  
7 may be possible, one thing is clear. These problems cannot be  
8 resolved on the timetable envisioned by the Draft Rules and  
9 provide yet another reason to delete Cooperatives from their  
10 coverage.

11 D. The Draft Rules threaten the Cooperatives' Federal  
12 loans.

13 As RUS told FERC in its open access filing, "A  
14 regulatory scheme that leads to defaults on Government loans to  
15 electric cooperatives, requiring taxpayers to absorb transition  
16 costs ... would be contrary to the spirit of both the Energy  
17 Policy Act and the RE Act."

18 The Draft Rules contain two provisions which would  
19 constitute an event of default under the Cooperatives' loans:  
20 (1) the loss of exclusive territorial service rights and (2) the  
21 requirement that distribution cooperatives make available member  
22 load to power suppliers other than AEPCO or their G&T.

23 Article III, Section 1(g) of the RUS mortgage states a  
24 default occurs when:

25 "(g) the Mortgagor shall forfeit or otherwise  
26 be deprived of its corporate charter or  
franchises, permits, easements or licenses  
required to carry on any material portion of  
its business;" (Emphasis added.)

1 The exclusive service rights underlying the CC&N have always been  
2 considered to be such a franchise or license. The loss of those  
3 rights will be a default on the mortgage.

4 Similarly, the all-requirements contract between the G&T  
5 and the distribution cooperatives provides security to RUS for its  
6 loans and loan guarantees to the G&T. Consequently, RUS ensured  
7 that distribution cooperatives will not breach the all-  
8 requirements contract by making any such breach a default in the  
9 loan RUS has with the distribution cooperative. Section 6.15 of  
10 the Loan Contract for electric distribution borrowers states:

11 The Borrower shall not materially breach any  
12 obligation to be paid or performed by the  
13 Borrower on any contract, or take any action  
14 which is likely to materially impair the value  
15 of any contract, which has been pledged as  
16 security to the RUS by the Borrower or any  
17 entity. (7 CFR 1718, Subpt. C, App. A.,  
18 Section 6.15) (See also 7 CFR 1718, Subpt. C,  
19 App. A, Section 4.1(I)).

20 Therefore, if a member distribution cooperative makes  
21 available member distribution load to competition (as is required  
22 by the Draft Rules) and that member load is pledged as security to  
23 the RUS (as is the case with AEPCO and its member distribution  
24 cooperatives), then that contract has been materially impaired and  
25 the distribution cooperative again has breached its mortgage with  
26 the RUS.

23 **E. Voluntary, not mandatory, participation by Cooperatives**  
24 **will avoid these problems.**

25 Consumer owned cooperatives are interested in bringing  
26 whatever competitive benefits the market can offer to the rural

1 areas of the state. Our customers deserve and will demand through  
2 our democratic structure nothing less.

3 The voluntary route suggested here to that goal will  
4 afford Cooperatives time to logically move to that result.

5 **II. SPECIFIC DRAFT RULE COMMENTS.**

6 The Cooperatives offer the following specific comments  
7 in relation to the Draft Rules. The short response time has  
8 impacted substantially our ability to undertake a thorough  
9 analysis.

10 As a threshold matter, we note that many portions of the  
11 Draft Rules simply make no sense as applied to AEPCO because of  
12 its structure and load characteristics. Nonetheless, AEPCO, a  
13 wholesale G&T, has been defined as an "Affected Utility." For  
14 example, AEPCO has no 1995 system retail peak demand to make  
15 available to competitive generation supply as required by R14-  
16 2xxx4.A., B. and D. It had only wholesale loads in 1995.  
17 Similarly, R14-2-xxx2, R14-2-xxx6 and many other Draft Rules  
18 can't, in several areas, be read logically to apply to AEPCO.  
19 This is another indication of the failure of the Draft Rules to  
20 consider the different nature of the non-vertically integrated  
21 AEPCO cooperative system.

22 Second, the Cooperatives had anticipated a gradual  
23 phaseout of regulatory oversight in step with the introduction of  
24 competition. The Draft Rules do not include such a lessening of  
25 the regulatory scheme. The Cooperatives believe they should.  
26

1 We now proceed to our specific comments and  
2 recommendations on the Draft Rules.

3 R14-2-xxx1.1. Definitions. Text of Draft Rule.

4 "Affected Utilities" means the following public service  
5 corporations providing electric service:

6 Tucson Electric Power Company, Arizona Public  
7 Service Company, Citizens Utilities Company,  
8 Arizona Electric Power Cooperative, Trico  
9 Electric Cooperative, Duncan Valley Electric  
10 Cooperative, Graham County Electric  
11 Cooperative, Mohave Electric Cooperative,  
12 Sulphur Springs Valley Electric Cooperative,  
13 Navopache Electric Cooperative, Ajo  
14 Improvement District, and Morenci Water and  
15 Electric Company.

16 Comment:

17 Of the 13 identified Affected Utilities, about half, or  
18 six of them are AEPCO and its five Arizona member distribution  
19 cooperatives.<sup>2</sup> This imposes a tremendously disproportionate  
20 burden on AEPCO's cooperative system. For example, the AEPCO  
21 system would have to coordinate, prepare and file six tariffs by  
22 June 30, 1997. Six company specific hearings would then have to  
23 be conducted on a multitude of issues.

24 Also, as already discussed, there are a number of issues  
25 peculiar to cooperatives which need to be addressed prior to the  
26 introduction of competition. These include Rules triggered  
27 mortgage default, the cooperatives' threatened tax exempt status,  
28 future financing and competitive facilities' use uncertainties  
29 because of RE Act Beneficiary restrictions and the G&T/

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25 <sup>2</sup> A seventh is the Navopache Electric Cooperative, a  
26 distribution cooperative member of the Plains G&T system based in  
New Mexico.

1 distribution/retail member all requirements contract and corporate  
2 structure restrictions.

3 Recommendation:

4 Deletion of cooperatives from the listing of "Affected  
5 Utilities" would afford more time to resolve issues peculiar to  
6 them and would avoid this immediate and disproportionate burden  
7 imposed on the AEPCO system by the Draft Rules. Once these issues  
8 are resolved, when any cooperative chose through its members'  
9 decision to participate, it would be subject to the same  
10 reciprocity requirements imposed by R14-2-xxx11.

11 For the reasons stated, the Cooperatives' primary Draft  
12 Rules recommendation is that they be exempted from mandatory  
13 participation. The more specific recommendations which follow are  
14 not inconsistent with this primary position, but are offered in  
15 the event the Commission does not accept it.

16  
17 R14-2-xxx1. Definitions.

18 General Comments:

19 The rules use the term "company" throughout without  
20 definition. Use of the term "person" broadly defined would be  
21 advisable. Similarly, "customer" and "consumer" are used  
22 interchangeably throughout without definition. One term should be  
23 used consistently.

24 . . .

25 . . .

26 . . .

1 R14-2-xxx1. Definitions and R14-2-xxx4.A-D. Competitive Phases.

2 Comments:

3           An additional definition is needed concerning  
4 constrained system capabilities together with companion changes to  
5 a subsequent Rule. To the extent load is supplied by generation  
6 external to the system, it impacts the ability to provide reliable  
7 service to all customers. Each system has a limit to import  
8 capability. First, a certain amount of on-line generation is  
9 required to provide reactive support and/or real support (e.g.  
10 spinning or supplemental reserves) to the transmission system.  
11 This restricts the ability to import some resources. Second, the  
12 system may not have import capability because of transformer and  
13 other transmission constraints which have been reached  
14 operationally. Third, if the system is at maximum import level,  
15 there may be no room left on the system to maintain the system's  
16 generators in a position to cover the cost of import with the  
17 resultant reliability issues.

18 Recommendation:

19           Add a new definition as follows:

20           "Available Transmission Capability" has the  
21 meaning accorded it by the Federal Energy  
22 Regulatory Commission in Order 888 (III FERC  
23 Stats. & Regs. ¶ 31,036,1996) ("Order 888").

24 Correspondingly, in R14-2-xxx4, add the phrase "Subject to  
25 Available Transmission Capability as regards both real and  
26 reactive power" at the beginning of paragraphs A and B. At the  
conclusion of paragraph D after "to 2003" add "within the limits  
of Available Transmission Capability."

1 R14-2-xxx1.5. Definitions. Text of Draft Rule.

2 "Stranded Investment" means the verifiable net  
3 difference between the value of all the prudent jurisdictional  
4 assets under traditional regulation of Affected Utilities and the  
5 market value of those assets directly attributable to the  
6 introduction of competition under this Article.

5 Comment:

6 Stranded Investment should include all asset values and  
7 costs which are caused by or otherwise would be recovered from  
8 retail customers but for retail competition as well as any  
9 regulatory assets required to be written off.

10 Recommendation:

11 It is premature to attempt a definition of stranded  
12 costs or investment at this early stage of the process. However,  
13 at a minimum, any definition should include recovery of all  
14 stranded capital investment, costs and regulatory assets (e.g.  
15 deferred pension costs, reclamation obligations, etc.) caused by  
16 competition. We would recommend deletion of the definition and  
17 scheduling of a docket for evidentiary hearings to determine an  
18 appropriate definition as well as a uniform process for recovery.

20 R14-2-xxx1.7. Definitions. Text of Draft Rule.

21 "Unbundled Service" means electric service elements  
22 provided and priced separately, including such service elements as  
23 generation, transmission, distribution, and ancillary services.  
24 Unbundled Service may be sold to consumers or to other suppliers  
25 of consumers.

24 Comment and Recommendations:

25 Other service elements or system items might be  
26 unbundled. The phrase "including but not limited to ..." would

1 clarify this definition. Additionally, add the phrase "as  
2 contemplated by the FERC in Order 888" after ancillary services.  
3

4 R14-2-xxx2. Filing of Tariffs by Affected Utilities. Text of  
5 Draft Rule.

6 Each Affected Utility shall file tariffs consistent with  
7 this Article by June 30, 1997 to allow retail electric competition  
8 in its service territory.

9 Comment:

10 Should cooperatives still be included in the Draft  
11 Rules, June 30, 1997 is a completely inadequate time allowance for  
12 analysis and preparation of such complicated tariffs -  
13 particularly so in the case of the AEPCO system as discussed  
14 previously. The deadline should be extended at least six months.  
15 Additionally, staggered deadlines by size of Affected Utility  
16 would allow better resource management by both the Commission and  
17 utilities.

18 Recommendation:

19 At a minimum, rewrite the Rule as follows:

20 Each Affected Utility shall file tariffs  
21 consistent with this Article by December 31,  
22 1997 to allow retail electric competition in  
23 its service territory.

24 R14-2-xxx3. Certificates of Convenience and Necessity.

25 Comments and Recommendations:

26 As currently drawn, this Rule can be read to allow  
certification of competing facilities based distribution systems  
in the same geographic area. This obviously would lead to

1 unnecessary, duplicative capital investment. The Cooperatives do  
2 not believe such a result was intended and the Rule should be  
3 amended to make that clear.

4  
5 R14-2-xxx3.C Certificates of Convenience and Necessity.

6 This paragraph requires notice of a competing CC&N  
7 application to an Affected Utility but is vague as to the details  
8 of that process.

9 Recommendation:

10 Add the following at the end of paragraph C: "by serving  
11 a complete copy of the Application on the Affected Utility."

12  
13 R14-2-xxx3.F. Certificates of Convenience and Necessity. Text of  
14 Draft Rule.

15 In appropriate circumstances, the Commission may  
16 require, as a precondition to certification, the procurement of a  
17 performance bond sufficient to cover any advances or deposits the  
18 applicant may collect from its customers, or order that such  
19 advances or deposits be held in escrow or trust.

20 Comment:

21 This section suffers from a variety of mechanical and  
22 conceptual problems. As written, it is completely inadequate to  
23 cover potential customer losses due to a failure by a competing  
24 entity to deliver power for an extended period of time or  
25 fraudulent service commitments. Also uncovered are corollary  
26 damages to connecting or Affected Utilities associated with such a  
performance failure. Further, how would the bond be sized to  
accommodate future growth? To whom would the bond be payable?  
How would an event of default be defined? Who would judge when

1 that has occurred? Finally, who would administer the payment of  
2 claims under and the proceeds of the bond?

3 Recommendation:

4 Adequate assurances must be required of service  
5 providers who will seek the opportunities presented by the Draft  
6 Rules but who will not present sufficient assets, local  
7 credentials and financial resources to cover the risk exposure of  
8 customers and others injured by their nonperformance. AEPCO is  
9 unable to offer specific amendments to address these issues at  
10 this time. However, the concept of the paragraph and the issues  
11 it raises are illustrative of the dangers inherent in a headlong  
12 rush to competition.

13  
14 R14-2-xxx4. Competitive Phases.

15 Subsections A-E of this Draft Rule contemplate an  
16 aggressive timetable of introduction and ramping to full  
17 competition between January 1, 1999 and January 1, 2003.

18 Comment:

19 As currently drafted, the timetable envisions the  
20 Commission and/or Affected Utilities designing and filing tariffs,  
21 analyzing and designing customer selection methodologies,  
22 addressing a myriad of technical and system reliability issues,  
23 participation in and the conduct of hearings, approval of tariffs  
24 and certification of competitors in a less than two year time  
25 frame before January 1, 1999. In contrast, a fairly routine  
26 Class B utility rate case takes 13 months for Staff analysis,

1 hearing and Order issuance. Small distribution cooperatives with  
2 limited resources will simply be unable to meet this timetable.  
3 As discussed previously, the aggressive schedule will also not  
4 allow adequate time for cooperatives to address and/or avoid, if  
5 possible, the impact of mortgage default, tax exemption and other  
6 issues peculiar to them.

7 Recommendation:

8 At a minimum, extend each of the dates by at least one  
9 year. Alternatively, and preferably, delete cooperatives from the  
10 list of Affected Utilities.

11 Also, to guard against cross-subsidization, a new item 4  
12 should be added to A and B as follows:

- 13 4. Any consumer which elects to  
14 participate in the competitive  
15 market after January 1, 1999 shall  
16 pay all costs attributable to such  
17 election including but not limited  
to special metering costs and any  
costs required to relieve  
transmission or distribution  
constraints.

18 This provision recognizes the fact that special metering  
19 provisions may be necessary and that certain geographic areas are  
20 constrained in their ability to import market power.

21 Finally, for clarity, we would suggest the following  
22 rewording of R14-2-xxx4.C:

23 Prior to 2001, no single consumer shall  
24 receive more than 20 percent of the total  
25 available kW 1995 system retail peak demand  
26 set aside for competitive generation supply in  
a given year in an Affected Utility's service  
territory.

1 R14-2-xxx4.F. Competitive Phases. Text of Draft Rule.

2 Consumers served under existing contracts are eligible  
3 to participate in the competitive market prior to expiration of  
4 the existing contract only if the Affected Utility and the  
5 consumer agree.

6 Comments:

7 The sanctity of contract is an important legal principle  
8 which appropriately has been recognized here. However, the text  
9 arguably may be too constraining in the case of cooperatives. As  
10 discussed earlier, a series of contractual relationships binds  
11 each consumer in the cooperative system together - retail member  
12 consumer to retail distribution cooperative consumer to G&T.  
13 Those contracts should not and cannot be impaired.

14 Recommendation:

15 Rewrite the Rule as follows:

16 Consumers or other entities served under  
17 existing contracts are eligible to participate  
18 in the competitive market prior to expiration  
19 of the existing contract only if the Affected  
20 Utility and the consumer or other contracting  
21 entity agree.

22 R14-2-xxx4.G.4. Buy-Throughs. Text of Draft Rule.

23 The Affected Utility shall permit customers to identify  
24 electricity sources which the Affected Utility would obtain on  
25 behalf of the customer and provide to the customer at unbundled  
26 rates described in Subsection R14-2-xxx6, below, plus the cost of  
the electricity plus a mark-up on the cost of electricity not to  
exceed 15 percent of the cost of the electricity.

Comment:

Buy-throughs should also be subject to Available  
Transmission Capability. Buy-throughs, as a wholesale purchase  
practical matter, should not be mandated in less than one megawatt

1 increments and any special costs required to assure system  
2 reliability or accommodate/support the customer should be borne by  
3 the customer.

4 **Recommendation:**

5 Reword subsection G.4. as follows:

6 The Affected Utility shall permit customers to  
7 identify electricity sources which the  
8 Affected Utility would obtain subject to  
9 Available Transmission Capability on behalf of  
10 the customer and provide to the customer. The  
11 rates for that service shall include the  
12 unbundled rates described in Subsection R14-2-  
13 xxx6, below, plus the cost of the electricity  
14 plus a mark-up on the cost of electricity not  
15 to exceed 15 percent of the cost of the  
16 electricity.

17 Also add new subparagraphs 6 and 7 to paragraph G as  
18 follows:

- 19
- 20 6. No Affected Utility shall be  
21 required to purchase or schedule a  
22 buy-through in less than quantities  
23 of one full megawatt.
- 24 7. Any buy-through consumer shall pay  
25 all costs necessary to accommodate  
26 the buy-through including but not  
limited to costs necessary to  
support the customer or assure  
system reliability.

20 **R14-2-xxx5. Competitive Services. Text of Draft Rule.**

21 A. A properly certificated electric company may offer  
22 any of the following services under bilateral or multilateral  
23 contracts with consumers:

- 24 1. Distributed energy services at market based  
25 rates (serving one or more consumers located  
26 in proximity, and not necessarily requiring  
transmission service from others).
2. Central station generation services at market  
based rates (generation serving one or more

1 consumers located at a distance from consumers  
2 and requiring transmission service, some  
ancillary services, and possibly distribution  
service).

3 3. Combinations of distributed and central  
4 station generation services.

5 B. A company other than an Affected Utility may  
6 provide services described in Subsection R14-2-xxx6  
after filing appropriate tariffs and receiving  
Commission approval of those tariffs.

7 Comments:

8 The Draft Rule stops considerably short of authorizing a  
9 truly competitive free market. Either price caps or minimums will  
10 put a provider at a competitive disadvantage (the minimum) or  
11 deprive it of the upside risk (the price cap). Also, the Rule  
12 should make it clear that the consumer shall bear the costs  
13 associated with the competitive service decision.

14 Recommendations:

15 Rewrite R14-2-xxx5 as follows:

16 A. A properly certificated electric company including  
17 an Affected Utility may offer any of the following  
18 services under bilateral or multilateral contracts  
with consumers:

19 1. Distributed energy services priced at  
20 unregulated market based rates without regard  
21 to cost of service (serving one or more  
consumers located in proximity, and not  
necessarily requiring transmission service  
from others).

22 2. Central station generation services priced at  
23 unregulated market rates without regard to  
24 cost of service (generation serving one or  
25 more consumers located at a distance from  
consumers and requiring transmission service,  
some ancillary services, and possibly  
distribution service).

1                   3.     Combinations of distributed and central  
2                         station generation services.

3           B.     A company other than an Affected Utility may only  
4                 provide services described in Subsection R14-2-xxx6  
5                 after filing appropriate tariffs and receiving  
6                 Commission approval of those tariffs.

7           C.     The consumer shall pay for any costs including but  
8                 not limited to metering, equipment, distribution or  
9                 transmission costs required to allow the consumer  
10                to receive competitive services.

11           R14-2-xxx6.A.   Services Required to be Made Available by Affected  
12           Utilities.   Text of Draft Rule.

13                 Until the Commission determines that competition has  
14                 been substantially implemented, each Affected Utility shall make  
15                 available to all consumers in its service area, as defined on the  
16                 date indicated in Subsection R14-2-xxx2, Standard Offer bundled  
17                 generation, transmission, ancillary, distribution and other  
18                 necessary services at regulated rates.

19           Comment:

20                 Once a customer is served by a competitor, the Affected  
21                 Utility should no longer be required to plan and build plant  
22                 necessary to service that customer's load and the obligation to  
23                 serve should cease. Otherwise, customers which remain will  
24                 continue to bear the costs of providing a generation, transmission  
25                 and distribution safety net for the departing customer. Departing  
26                 customers similarly will enjoy the cost free luxury of shifting  
                  from a competitor to the Affected Utility and back again depending  
                  upon the relationship between marginal costs and average imbedded  
                  costs. Finally, the Rule would result in inefficient, duplicative  
                  costs - both the competitor and the Affected Utility would  
                  maintain plant to serve the same customer.

...

1 Recommendation:

2 Authorize a sizable re-entry fee to discourage such  
3 shifting and make service restoration discretionary.

4 Alternatively, amend the Draft Rule to require Standard Offer  
5 service only to those customers who do not elect to leave the  
6 system.

7  
8 R14-2-xxx6.C.4. Services Required to be Made Available by  
Affected Utilities.

9 Comment and Recommendation:

10 Change "as defined by" to "in accordance with" in  
11 relation to Ancillary Services. Order 888 has many provisions  
12 relating to Ancillary Services other than just the definition.

13  
14 R14-2-xxx7.A. Recovery of Stranded Investment of Affected  
15 Utilities. Text of Draft Rule.

16 The Affected Utilities shall take every feasible, cost-  
17 effective measure to mitigate or offset Stranded Investment by  
18 means such as accelerated depreciation of assets, expanding  
wholesale or retail markets, or offering a wider scope of services  
for profit, among others.

19 Comment:

20 This paragraph conflicts with paragraph F of the same  
21 rule which provides that Stranded Investment may only be recovered  
22 from customers served competitively. Accelerated depreciation of  
23 assets, if feasible, will be recovered from the utility's customer  
24 base. For cooperatives, it is doubtful the RUS would approve  
25 accelerated depreciation as a mitigation measure since it would  
26 imperil its mortgage security. Realistically, general mitigative

1 measures such as accelerated depreciation which are deemed to be  
2 in the public interest should be supported by all customers and  
3 any unmitigated costs caused by retail competition should be borne  
4 by customers served competitively. In any event, it is premature  
5 for the Commission to restrict its discretion in acting in this  
6 area.

7 Recommendation:

8 Strike R14-2-xxx7.F in its entirety and re-letter the  
9 remaining paragraphs.

10  
11 R14-2-xxx7.B. Recovery of Stranded Investment of Affected  
Utilities. Text of Draft Rule.

12 The Commission may allow recovery of unmitigated  
13 Stranded Investment by Affected Utilities.

14 Recommendation:

15 Consistent with the requirements of the United States  
16 and Arizona Constitutions change "may" to "shall."

17  
18 R14-2-xxx7.E. Recovery of Stranded Investment of Affected  
Utilities. Text of Draft Rule.

19 The Commission shall determine for each Affected Utility  
20 which files Stranded Investment data and recovery proposals  
21 consistent with this Article appropriate Stranded Investment  
22 recovery mechanisms and charges. In making its determination, the  
23 Commission shall consider at least the following factors:

- 24 1. The impact of Stranded Investment recovery on the  
25 effectiveness of competition.
- 26 2. The impact of Stranded Investment recovery on customers  
of the Affected Utility who do not participate in the  
competitive market.
3. The impact of partial or no recovery of Stranded  
Investment on the Affected Utility and its shareholders.

4. The impact of Stranded Investment recovery on prices paid by customers who participate in the competitive market.
5. The degree to which the Affected Utility has mitigated or offset Stranded Investment.
6. The degree to which some assets have values in excess of their book values.
7. Appropriate treatment of negative Stranded Investment.
8. The time period over which such Stranded Investment charges may be recovered. The Commission shall limit the application of such charges to a specified time period.
9. The ease of determining the amount of Stranded Investment.
10. The amount of electricity generated by renewable generating resources owned by the Affected Utility.

Comment and Recommendations:

Factors 1, 4 and the second sentence of 8 should be stricken. As to 1 and 4, recovery obviously will impact the prices under and effectiveness of competition but that does not change the fact that its beneficiaries should bear fair, transitional burdens. The second sentence of Factor 8 may inappropriately assume an arbitrary time frame in which recovery would occur and end regardless of whether recovery was complete.

Factor 3 should be modified, in the case of cooperatives, to include a reference to lienholders and members. Finally, Factor 9 may be problematic if the difficulty in determining the amount of Stranded Investment is used as an excuse not to allow recovery.

1 R14-2-xxx7.I. Recovery of Stranded Investment of Affected  
2 Utilities. Text of Draft Rule.

3 In no event shall recovery of Stranded Investment occur  
4 after December 31, 2004.

5 Comment:

6 Pragmatically, it will be impossible to recover Stranded  
7 Investment by the end of 2004 when full competition doesn't occur  
8 until the previous year. Legally, such a uniform presumptive  
9 cutoff date is arbitrary, capricious, unreasonable and unlawful.

10 Recommendation:

11 Delete R14-2-xxx7.I. in its entirety.

12 R14-2-xxx9. Solar Portfolio Standard.

13 This Draft Rule establishes a Solar Portfolio Standard  
14 requiring companies selling electricity under the provisions of  
15 this Article to secure one percent by 1999 and two percent by 2002  
16 from solar resources. Although vague, these requirements would  
17 appear to apply to Affected Utilities because paragraph F states  
18 the mandates are in addition to renewable resource goals  
19 established in the last round of Resource Planning.

20 Comment:

21 There is ample room for voluntary measures to continue  
22 to foster the growth of solar resources, but no reason for such a  
23 mandate. In the 1990 resource planning cycle, this Commission  
24 rejected a mandatory "rebuttable presumption" in favor of solar.  
25 Three years ago, the Commission again rejected the same notion -  
26 this time in the form of "mandatory set asides." Now, the same

1 idea resurfaces as a mandated "Solar Portfolio Standard." The  
2 Commission should reject the concept again.

3 First, the power is not needed. AEPCO will not need new  
4 capacity until 2004, five years after this Draft Rule would  
5 arguably mandate roughly five new MW of solar. Any resources  
6 required to satisfy this standard will displace used and useful  
7 existing resources and create, not mitigate, stranded investment.  
8 Second, the costs are prohibitive. While installed solar prices  
9 have dropped somewhat recently, they remain about four times more  
10 expensive than AEPCO's installed average imbedded cost per kW.  
11 Third, the Draft Rule is discriminatory and would disadvantage  
12 Affected Utilities in the competitive market by requiring  
13 adherence to the Solar Portfolio standard and the IRP solar goals.  
14 Competitors need only meet the former standard, not the latter.  
15 Finally, the concept, of course, is antithetical to the basic idea  
16 of the Draft Rules - a move to a system of market driven supply  
17 and demand. Consumers and utilities, of course, should be free to  
18 select and offer "green" pricing.

19 Recommendation:

20 Delete R14-2-xxx9 in its entirety. Alternatively,  
21 delete paragraph F and apply the standard solely to new entrants  
22 or make it clear that Affected Utilities are only subject to the  
23 renewable resource goals established in Decision No. 58643.

24 . . .

25 . . .

26 . . .

1 R14-2-xxx10. Pooling of Generation and Centralized Dispatch of  
2 Generation or Transmission. Text of Draft Rule.

- 3 A. The Commission shall conduct an inquiry into  
4 pooling and dispatch arrangements for transmission  
5 and generation of electricity.  
6 B. The Commission may establish a pool for generation  
7 or centralized dispatch of generation or  
8 transmission by an independent system operating or  
9 by other means.  
10 C. The Commission may work with other entities to  
11 establish a pooling or centralized dispatch of  
12 generation or transmission.

13 Comments:

14 The Cooperatives are quite familiar with pooling  
15 concepts since they have been operating a successful one for  
16 decades. However, the Commission is free to engage in all this  
17 activity without promulgating a Rule. It seems unnecessary to  
18 include these provisions in the Draft Rules, particularly at this  
19 stage.

20 R14-2-xxx11. In-State Reciprocity. Text of Draft Rule.

21 The service territories of Arizona electric utilities  
22 which are not Affected Utilities shall not be open to competition  
23 under the provisions of this Article, nor shall Arizona electric  
24 utilities which are not Affected Utilities be able to compete for  
25 sales in the service territories of the Affected Utilities.  
26 However, an Arizona electric utility which is not an Affected  
Utility may voluntarily participate under the provisions of this  
Article if it makes its service territory available for competing  
sellers, if it agrees to all of the requirements of this Article,  
and if it obtains an appropriate Certificate of Convenience and  
Necessity.

27 Comments:

28 The Rule should be drafted broadly enough to require  
29 reciprocity in the case of an entity affiliated with a competitor

1 entering the market. Otherwise, the Rule will be easily avoided.  
2 Similarly, the Rule should be broadened to require that out-of-  
3 state entities or their affiliates' home states as a condition of  
4 certification must allow reciprocity for Arizona Utilities.  
5 Finally, the Commission should be aware that this provision will  
6 not place non-ACC rate regulated competitors in the same posture  
7 as Affected Utilities. Entities not regulated by the Commission  
8 may subtly allocate more expensive resources to their captive  
9 customer base and apply less expensive ones to their external  
10 competitive efforts.

11 R14-xxx12. Rates.

12 This Draft Rule sets out an elaborate rate filing and setting  
13 scheme which is thoroughly inconsistent with a competitive  
14 marketplace. As is the case in many other areas of these Draft  
15 Rules, the result is a highly regulated competitive marketplace  
16 which will be adverse both to consumer and utility interests. The  
17 Commission should first seek necessary legislative and  
18 constitutional changes to rationally move toward a lawfully and  
19 logically restructured industry.

20  
21 R14-2-xxx13.N. and O. Service Quality, Consumer Protection,  
22 Safety, and Billing Requirements.

23 Comments and Recommendations:

24 As to paragraph N, the working group should commence  
25 activities as soon as possible to begin to grapple with critical  
26 system reliability and safety issues.

1 As to paragraph O, all parties offering service should  
2 be required to become members of the Western Systems Coordinating  
3 Council.

4 DATED this 12th day of September, 1996.

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1 Original and 10 copies of the  
2 foregoing were filed this 13<sup>th</sup>  
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3 Docket Control  
4 Arizona Corporation Commission  
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5 Copy of the foregoing hand-delivered  
6 this 13<sup>th</sup> day of September, 1996, to:

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